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**B R A Z I L**

**MODERNIZATION AND INSTITUTIONAL STRENGTHENING OF  
THE CVM**

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**MODERNIZATION AND INSTITUTIONAL STRENGTHENING OF THE  
COMISSÃO DE VALORES MOBILIÁRIOS (CVM)**

**(TC-01-06-03-4-BR)**

**DONORS MEMORANDUM**

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## ABBREVIATIONS

BCB	Banco Central do Brasil [Central Bank of Brazil]
BM&F	Bolsa de Mercadorias e Futuros [Commodity and Futures Exchange]
CESI	Committee on Environment and Social Impact
CETIP	Central de Custódia e de Liquidação Financeira de Títulos [Central Agency for Custody and Financial Settlement of Securities]
CVM	Comissão de Valores Mobiliários [Securities Commission]
EU	European Union
FTAA	Free Trade Area of the Americas
IAS	International Accounting Standards
MERCOSUR	Common market of the southern cone
PMU	Project management unit
PPMR	Project Performance Monitoring Report
TOR	Terms of reference
UNDP	United Nations Development Programme
U.S. GAAP	General Accepted Accounting Principles in the United States
WTO	World Trade Organization

# MODERNIZATION AND INSTITUTIONAL STRENGTHENING OF THE COMISSÃO DE VALORES MOBILIÁRIOS (CVM)

(TC-01-06-03-4-BR)

## EXECUTIVE SUMMARY

<b>Requester and executing agency:</b>	Comissão de Valores Mobiliários [Securities Commission] (CVM)	
<b>Beneficiaries:</b>	The program beneficiaries are businesses and investors using the Brazilian capital market and the various actors.	
<b>Amount and source:</b>	Nonreimbursable MIF Local counterpart (CVM): Total:	Facility I US\$2,000,000 US\$2,000,000 US\$4,000,000
<b>Execution timetable:</b>	Execution period: Disbursement period:	36 months 42 months
<b>Objectives:</b>	The general objective of the program is to deepen the Brazilian capital market through its specific objective, the strengthening and modernization of its regulatory and oversight agency, the CVM. The program is based on activities grouped into three tacks: (i) improved legal framework covering regulated/supervised entities; (ii) deepened knowledge on the part of the CVM regarding competitiveness and the comparative legislation of Brazilian reference markets; and (iii) improved procedures to support market transparency from three perspectives, to wit, relevant facts generated by the market, supervision of trading in the markets, and subjects involved in the daily operation of the markets.	
<b>Description:</b>	The three tacks mentioned are broken down into five components, the first of which seeks to update the regulatory framework and its integration with other markets through: (i) the regulation of the derivatives market as a whole, particularly of markets subjected for the first time to the CVM (raw materials and nonmarket asset derivatives); (ii) the overall consolidation of the CVM's regulations; and (iii) the analysis of legislations of the Southern Common Market (MERCOSUR) countries for subsequent integration. The second component seeks to analyze the competitiveness of Brazil's reference	

markets (MERCOSUR, Chile, and the main international markets) from the standpoint of the competitive greenmail that the markets in developing countries have experienced in order to take the next measures in the process of modernization initiated in the country. The last three components seek to promote transparency in the Brazilian markets from different standpoints. The third seeks to modernize the entire process of registration of issues of bearer securities and the disclosure to the public of significant facts occurring in the market from the standpoint of the historic store of the most important facts and the mechanisms for future processing thereof. The fourth component aims to endow the CVM with the tools necessary to control the behavior of markets subjected to its supervision for the first time, assuming a significant jump forward in the quality of the existing monitoring mechanisms. The fifth component seeks to modernize the requirements for access by different types of actors (natural persons) in Brazilian capital markets, to design a professional quality certification program and a professional quality national certification system.

**Environmental  
and social  
review:**

The Technical Review Group of the Committee on Environment and Social Impact reviewed and approved the project proposal at its 1 February 2002 meeting and made one observation that has been taken into account in the design of the program (see paragraphs 3.9 to 3.12).

**Special  
contractual  
clauses:**

The special contractual conditions are as follows:

1. As a condition precedent to the first disbursement of the contribution, the CVM will present evidence that the project management unit (PMU) has the functional capacity and staff needed to execute the program.
2. Prior to the start of each year of program execution, the CVM will present budget items substantiating each program action for the following year.
3. As a condition precedent to disbursement of the resources for actions to prepare consolidated regulations for the CVM's policy and legislation, called for under component I, the CVM must present evidence that the process of updating the affected regulations—supported by the World Bank—has been completed.

**Exceptions to  
Bank policy:**

None.

## **I. COUNTRY AND PROGRAM ELIGIBILITY**

- 1.1 Brazil was declared eligible for all the modalities of Multilateral Investment Fund (MIF) financing on 5 February 1995. The program itself is eligible in the context of the Technical Cooperation Facility (Facility I), inasmuch as its basic objective is to strengthen capital markets by improving supervision thereof and the basic mechanisms for transparency that make their development possible. In this regard, the program is compatible with the objectives promoted by the MIF of strengthening and expanding private investment and financial markets as a foundation for economic growth and social development.

## **II. FRAME OF REFERENCE**

### **A. Sector**

- 2.1 Over the last few years, Brazil has undertaken and promoted a series of transformations in its economic framework aimed at consolidating sustained growth. In this context, the government considers strengthening and developing capital markets a priority since flexible and deep markets (both primary and secondary) are a sound alternative to bank financing and are a necessary condition for: (i) effective allocation of business and individual savings towards productive investment; and (ii) a drop in the cost of capital for those businesses. Both elements are key to financing the country's economic growth as the main instrument of development.
- 2.2 However, the role of Brazilian capital markets in business financing is still very limited despite high growth potential (among other reasons, because of the importance of institutional investment). The main causes can be found in: (i) the importance of the crowding out effect of public securities in the investments of individuals and banking institutions; (ii) the low liquidity of secondary markets caused by flaws in market transparency mechanisms and the corporate governance problems of businesses that obtain public savings in them; and (iii) possibly, some design problems that still exist in the market structure.

### **B. The country's sector strategy**

- 2.3 To cope with this situation, the Government of Brazil has instituted a series of legal measures, including Law 10,303/01, Law 10,411 of 26 February 2002, and Presidential Decree 3,995, which establish a new legal framework for capital markets that seeks to deepen the process of aligning the Brazilian securities market with those of the other members of the Southern Common Market (MERCOSUR) and with the main international markets. They highlight, among other things: (i) new corporate governance regulations and a new regulation to protect minority shareholders; (ii) the sending of bill 3,741 to Congress, which promotes an increase in the transparency of information through an alignment of accounting regulations

with the respective standards (International Accounting Standards (IAS) or General Accepted Accounting Principles in the United States (U.S. GAAP)); and (iii) more significant areas of responsibility for the Comissão de Valores Mobiliários [Securities Commission] (CVM).

- 2.4 In this last regard, the government believes that the existence of a high-quality regulatory agency is one of the essential elements to enhance market competitiveness since: (i) its work (both regulatory and of enforcement) is an unavoidable prerequisite for the ground rules, according to which the private sector carries out its activities, to be clear and for markets to flourish; (ii) its work is key to promoting and ensuring market transparency; and (iii) it is the only component of such competitiveness on which the public sector has a clear and direct impact.
- 2.5 This modernization process has been supported by the private sector through a series of structural changes (sponsored by the public sector), in particular agreements to merge the country's main stock exchanges and to create the NOVO MERCADO. Brazil has thus become the first country in the region to begin the process of restructuring its capital markets from a perspective of agreement between the public and private sectors. The Government of Brazil has asked the World Bank for support in this process, through a programmatic financial sector adjustment loan that is supported by a technical-assistance project and by the MIF through this operation.

### **C. Program strategy**

- 2.6 As the agency responsible for supervising and developing Brazil's capital markets, the CVM has been promoting the aforementioned reforms, issuing a series of directives for development of the new legislation (among others,<sup>1</sup> it recently issued regulations on the use of privileged information—Directive 358/02—and on public offerings for the purchase and sale of securities—Directive 361/02). At the same time, it has begun a process of internal, legal, organizational, and technical modernization in order to be able to take up its new responsibilities.
- 2.7 To this end, the CVM has had support from the aforementioned World Bank technical assistance project, in the amount of US\$6.8 million covering several areas including, in particular: (i) diagnostic studies on Brazil's capital markets, emphasizing the CVM's role therein; (ii) strengthening of regulations and compliance therewith; (iii) strengthening of market transparency; (iv) protection of investors and public information; (v) protection of mutual-fund investors; (vi) market supervision; and (vii) institutional support.<sup>2</sup>

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<sup>1</sup> CVM Directives 308/99, 323/00, 341/00, 342/00, 350/01, 355/01, 356/01, 359/01, and Resolution 2,785/00 of the National Monetary Council.

<sup>2</sup> This information is available in the files of RE1/FI1, which contains a summary of the specific contents of the technical assistance project.

2.8 As ambitious as this approach is, however, the MIF and the CVM agree that there are specific areas requiring a series of actions (in order to achieve overall strengthening of the agency) that have not been specifically targeted in the aforementioned technical-assistance project but that do complement it. From this standpoint, the program's design has sought to complete the technical-assistance project, while thoroughly making sure that there are no overlaps between the two operations and aiming for complementarity from two standpoints:

a. *From the standpoint of the individuality of each component of the operation*, the grounds for complementarity are different based on each, as follows:

- Component I: its own specificity ensures its complementarity;
- Component II: a different approach to the internationalization of markets since, compared with the standpoint of the listed companies adopted for the technical assistance project, the program tackles the component from the European approach of the last decade (competitiveness of market structures);
- Component III: a different approach to transparency since, compared with the technical-assistance project's focus on periodic financial information on businesses, the program approaches the component based on relevant facts produced by them and, in addition, the different weight given to the need for digitizing the CVM's main documentary store;
- Component IV: a different approach to the supervision of derivatives since, compared with the technical-assistance project's focus on diagnostic assessments, the program tackles the component from the approach of specific updating of the procedures stemming from the CVM's new responsibilities; and
- Component V: the technical-assistance project does not cover this area, presumably because of the CVM's failure to identify objectives at the time the project was being put together.

b. *From the standpoint of the design of the technical-assistance project*. The complementarity between the two operations is also based on the very design of the technical-assistance project since, out of the US\$6.8 million mentioned, US\$1.8 million have yet to be earmarked to conduct individual follow-up of certain consultancies specifically called for and in years two and three of project execution. The existence of the program, the CVM's willingness, and the special contractual condition set forth in paragraph 9.2, will make it possible for this type of resources from the technical-assistance

project to be used for purposes that, because they are identified later in the process, will arise from the first phase of the technical-assistance project but will have no overlap with the program.

- 2.9 There is another strategic approach in addition to the previous one. The CVM is the securities commission of the broadest and deepest market of the expanded MERCOSUR countries. The Brazilian market is also the only one in the region as a whole that has begun a comprehensive process to restructure capital markets. From this perspective, with the program the MIF is seeking to have the CVM act as the region's champion of market modernization and integration around the various components that comprise it. To this end, the following are important: (i) concrete initiatives such as those reflected in paragraphs 3.6 and 3.8, relating respectively to market integration and modernization; (ii) shared strategies currently being implemented;<sup>3</sup> and (iii) the likely effect in terms of other interested commissions emulating or monitoring the project.

### **III. THE PROGRAM**

#### **A. Objectives**

- 3.1 The generic objective of the program is to deepen the Brazilian capital market by strengthening its regulatory and supervisory agency, the CVM. Its specific objectives are to support the strengthening through activities along three tacks: (i) improved legal framework; (ii) deepened knowledge on the part of the CVM regarding competitiveness and the comparative legislation of reference markets; and (iii) improved procedures to support market transparency with respect to relevant facts generated by the market, supervision of trading in the markets, and the qualification of subjects involved in the daily operation of the markets.

#### **B. Program structure**

- 3.2 The three tacks are broken down into five components: (i) update of the regulatory framework and gathering of information to open the way for future integration processes; (ii) securities market competitiveness; (iii) support for transparency; (iv) supervision of derivatives market; and (v) design and institutionalization of a professional quality certification system in the securities market.

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<sup>3</sup> One that stands out is the SUNI Project, which involves dissemination of information and is made up of the CVM, the Argentine Securities Commission, the Chilean Superintendency of Securities and Insurance (SVS), and the National Securities Commission of Spain.

**1. Component I. Update of the regulatory framework and gathering of information to open the way for future integration processes. US\$374,000 (MIF: US\$141,000; CVM: US\$233,000)**

- 3.3 The recently modified legal framework for securities markets seeks to enable a rapprochement to international standards as well as to allow future integration processes within MERCOSUR. This regulatory change requires the CMV's legal framework to be updated, which process has already begun with the help of the World Bank.<sup>4</sup> However, there are areas related to the derivatives market and regulatory consolidation that still need to be covered in order to complete the legal framework necessary for the development of the securities market.
- 3.4 At the same time, the CVM is promoting the process of gradual harmonization and integration of the Brazilian securities market with those of the other countries of MERCOSUR and Chile. To this end, minimum standards on securities market regulation that each member country must follow have been approved.<sup>5</sup> In addition, the CVM is participating—in connection with capital market services—in the negotiations conducted in the context of the Free Trade Area of the Americas (FTAA) and the European Union (EU). In this regard, thorough knowledge of laws relating to the capital markets of each member country of MERCOSUR and Chile, based on the approach required by MERCOSUR or forums such as the FTAA, MERCOSUR-EU, or the World Trade Organization (WTO), becomes an essential tool to achieve market integration within and outside MERCOSUR. Accordingly, this component is divided into the following two subcomponents, which will be tackled through well-timed consultancies pursuant to the terms of reference (TOR) in Appendix 1.
- 3.5 *Subcomponent 1. Update of the regulatory framework.* This subcomponent is comprised of the following basic activities: (i) draft any regulations that need to be issued and/or amended now that the derivatives market as a whole is under the CVM's jurisdiction; and (ii) propose consolidated regulations for the CVM's policies and legislation after completion of the updating process supported by the World Bank's technical-assistance project that would not cover that aspect. Accordingly, any contractual clauses necessary to guarantee coordinated fulfillment of this last point will be established.
- 3.6 *Subcomponent 2. Integration.* The main activities of this subcomponent involve: (i) conducting a comparative analysis of the securities market legislation of MERCOSUR countries and Chile in the context of applicable MERCOSUR Common Market Council decisions; and (ii) preparing a series of comparative and individual charts on capital market services in the aforementioned countries. Both activities are clearly instrumental but essential to the CVM when it comes to

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<sup>4</sup> See paragraphs 2.7 to 2.9.

<sup>5</sup> Decisions 8/93 and 13/94 of the MERCOSUR Common Market Council.

continuing negotiations in the context of the FTAA and EU and providing the tools necessary to deepen the commitments undertaken vis-à-vis MERCOSUR.

**2. Component II. Securities market competitiveness. US\$211,000 (MIF: US\$116,000; CVM: US\$95,000)**

- 3.7 The ongoing globalization process has introduced inter-market competition that is putting the very survival of national markets at risk. Understanding this phenomenon requires a different analysis than the one provided for in a process of updating the legal framework for integration of the legislation of securities markets. Capital market competitiveness is based, to a large extent, on structural design elements that are the result of structures taken up at the regulatory level and realities emerging from the private initiative of market intermediaries and institutions. The CVM is aware of this and is interested in understanding the situation of its own market and those of Argentina, Chile, Paraguay, and Uruguay in relation to what could be called the state of the art vis-à-vis the competitiveness of more developed international markets in order to take appropriate measures in this regard.
- 3.8 Accordingly, this component, which will be approached through well-timed consultancies pursuant to the terms of reference in Appendix 2, will be comprised of the following main activities: (i) prepare a frame of reference on international best practices in markets where competitiveness has increased as reflected by the trading volume, dropping costs, and increased value added of supply chains; (ii) compare the frame of reference with the current situation in Brazil, Chile, Argentina, Paraguay, and Uruguay for purposes of making concrete recommendations to be applied in the Brazilian market. The areas of action to be taken into account in the analysis are: (i) supervision and various approaches thereto; (ii) primary markets and their operative conditions in respect of the liquidity and depth of secondary markets; (iii) the conditions and typology of the various actors involved in securities traffic and, more specifically, of the members of the markets; (iv) structural organization of the secondary markets; (v) investor protection mechanisms; (vi) fiscal context; and (vii) impact of technology, communications, and Internet. It should be noted that the outputs of this component, given their scope, will serve as a frame of reference not only for Brazil but also for the other MERCOSUR countries since the CVM intends to share them with its counterparts in MERCOSUR and Chile.

**3. Component III. Modernization of specific registration processes. US\$1,209,000 (MIF: US\$479,000; CVM: US\$730,000)**

- 3.9 As indicated in section II, the processes of transparent disclosure and dissemination of all the information needed on the issuer and its securities (i.e., financial position, performance, reorganization projects, relevant liabilities, including those related to the environment) are crucial to investment decision-making. In the current state of the technology, such processes are based essentially on the development of

information systems which, at the same time, have some clear benefits from the standpoint of market oversight by the regulatory and oversight agency. In view of this two-pronged relevance, the CVM has decided to modernize the processes affected by completing the World Bank's technical-assistance project<sup>6</sup> and with support from this operation. This component focuses on the filing of issues and on the digitization of the essential part of the body of knowledge of relevant facts and will be addressed through well-timed consultancies pursuant to the terms of reference in Appendix 3. It will be divided into the following two subcomponents:

- 3.10 *Subcomponent 1. Electronic filing of securities issues.* This subcomponent provides for three basic activities: (i) develop and install a control and validation mechanism that will allow the CVM to electronically receive, store, and make available documents related to significant facts affecting new or existing securities (including the status of the process of filing with the CVM); (ii) train CVM staff on the new system; and (iii) create a mechanism for management control and support of the CVM to allow its officers to measure improvements in productivity generated by the new system. Under this component, hardware and software will be procured, technical consultants specializing in the development of systems like the one mentioned will be hired, and technical assistance will be provided for a specific period.
- 3.11 *Subcomponent 2. Digitization.* This subcomponent involves transforming close to 4 million existing documents (considered relevant for the purposes of digitization, out of a total of 13 million documents) into digital format. This requires two types of consulting services to be carried out jointly. The first will consist of a review of the documents selected and preparation of same for digitization; the second will consist of the technological transformation of the documents through scanning and indexing. At the same time, the subcomponent will provide the CVM's documentation unit with the necessary technical and administrative support for the transformation process.

#### **4. Component IV. Supervision of the derivatives market. US\$899,000 (MIF: US\$467,000; CVM: US\$432,000)**

- 3.12 To supplement the process of updating regulations described in component I (specifically with respect to the derivatives market), the CVM is aware of the need to adjust and/or strengthen its oversight of the derivatives market now that law 10,303/01 puts under its jurisdiction not only the negotiation of securities derivatives (shares, derivatives, debentures, or other notes) but also the negotiation

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<sup>6</sup> The World Bank project seeks to strengthen the procedures for the filing periodic information delivered by companies making a public offering but not the relevant facts generated thereby, including in particular the stock operations and securities issues.

of any other derivative financial asset.<sup>7</sup> Now the CVM is responsible for supervising the negotiations in the Bolsa de Mercadorias e Futuros [Commodity and Futures Exchange] (BM&F), the Central de Custódia e de Liquidação Financeira de Títulos [Central Agency for Custody and Financial Settlement of Securities] (CETIP), and others. In this regard, the objective of this component, which will be undertaken through well-timed consultancies pursuant to the terms of reference in Appendix 4, will be to create a system of support for operations involving derivatives that assumes: (i) the implementation of a specific system for monitoring pricing and critical evaluation of operations conducted in organized markets, for purposes of evaluating the freedom of pricing; (ii) the proper processing of data received off-line that are sent by CETIP and the BM&F, identifying the participants of the negotiation and the parameters related to the transactions performed; and (iii) the creation of electronic filing systems for data and documents for the support area mentioned. Although this new system will use a functional design similar to the system used for supervision of the equity market,<sup>8</sup> it will be based on specific assumptions for the derivatives market. From the technical standpoint, the new design and specific platform will represent a qualitative jump within the CVM.

- 3.13 This component will therefore consist of the following main activities: (i) define the basic characteristics of the systems that take into account the three points described in the preceding paragraph; (ii) implement such systems; (iii) train CVM staff involved in the derivatives market, particularly on pricing for said market; and (iv) verify the results obtained from using such systems and make any adjustments deemed necessary as a result of the verification.

**5. Component V. Design and institutionalization of a professional quality certification system in the securities market. US\$798,000 (MIF: US\$670,000; CVM: US\$128,000)**

- 3.14 Under the previous components, the program focuses on the regulatory framework of the securities market and on its structure and design, for the purpose of achieving a Brazilian market that is more developed, competitive, and efficient and capable of integrating with the other countries in the region. With this fifth and final component, the program concentrates on another essential variable to achieve those objectives, the market actors. Indeed, quality control in respect of the various actors participating in securities intermediation is vital. For this reason, the CVM attaches maximum priority to deepening the process of registration, training and certification of the actors through the creation of a system to certify professional quality in the securities market.

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<sup>7</sup> Previously, the Central Bank of Brazil (BCB) or the commodities markets themselves were in charge of this task.

<sup>8</sup> Which is being modernized with support from the World Bank's technical assistance project.

- 3.15 In securities intermediation, the current regulations distinguish the following: (i) the autonomous investment agent (regulated pursuant to CVM Resolution 2,838 and CVM Directive 355); (ii) the securities portfolio administrator (regulated pursuant to CVM Directive 306); (iii) the securities analyst (provided for in Law 6,385 but for which no regulations have yet been issued); and (iv) employees of institutions that work with the investing public (provided for in CVM Resolution 2,838, but for which no regulations have yet been issued). And yet, there is no harmonized regime for a professional quality certification system for these individuals. In view of this situation, and based on the analysis conducted by the project preparation consultants, this component is divided into two subcomponents that will be executed through well-timed consultancies pursuant to the terms of reference in Appendix 5.
- 3.16 *Subcomponent 1. Design of the securities market professional quality certification program.* This subcomponent focuses on creating a new certification methodology for securities market professionals. The main activities will be: (i) analyze the structure and evolution of the occupational area of the stock market in the above professional categories; (ii) prepare occupational standards and define professional profiles; (iii) design a process of evaluation (ex post or test diagnostic instruments, such as objective tests, status tests, simulation guides, practical tests, group dynamics techniques); and (iv) prepare guidelines for learning that will be subjected to a validation process through technical missions to be implemented for that purpose.
- 3.17 *Subcomponent 2. Institutionalization of the Brazilian securities market professional quality certification system.* The objective of this subcomponent is to establish the Brazilian professional quality certification system, so that stakeholders (beneficiary public, employees, employers, etc.) accept, participate in, and complete, as applicable, the system design processes established under subcomponent 1. To this end, once the program described therein has been developed, a national council will be set up as the policy and regulatory forum for training and certification activities. The council will prepare a proposal for the creation of the Brazilian professional quality certification system and will be in charge of its dissemination and approval through the respective forums with the various associations and institutions involved in capital markets and in training for the private-sector actors. If there is not enough critical mass or interest on the part of the country's "securities industry" in this process of professional quality certification, the role of the national council will be assumed by the CVM itself.

## IV. COST AND FINANCING

### A. Cost

- 4.1 The total cost of the program is US\$4 million, which will be financed by the MIF and the CVM (50% each). In this regard, it should be noted that a significant percentage of the CVM's total contribution will be provided in cash (over 80%) and no more than 25% of the MIF resources are being used for technology (hardware or software). The resources allocated by the MIF and the CVM are detailed below.

<i>Components and/or costs</i>	<i>MIF (US\$)</i>	<i>CVM (US\$)</i>	<i>Total (US\$)</i>
1. Update of the regulatory framework and gathering of basic information to facilitate integration processes	141,000	233,000	374,000
2. Competitiveness of securities market	116,000	95,000	211,000
3. Support for transparency	479,000	730,000	1,209,000
4. Supervision of derivatives market	467,000	432,000	899,000
5. Certification of professional quality	670,000	128,000	798,000
6. Administration	0	306,000	306,000
7. Evaluation and audit	50,000	0	50,000
8. Contingencies	77,000	76,000	153,000
<b>Total</b>	2,000,000	2,000,000	4,000,000
<b>Percentage</b>	50%	50%	100%

### B. Sustainability

- 4.2 The very nature of the operation's components, the content of paragraph 7.4 (related to component V) notwithstanding, guarantees its sustainability. The operation of the CVM itself and its financial and budgetary autonomy as described in paragraph 5.1 ensures that the knowledge acquired, the systems built, and the regulations issued or consolidated will bear the expected fruit.

## **V. PROGRAM EXECUTION**

### **A. Executing agency**

- 5.1 The program's executing agency will be the CVM, which has its main headquarters in Rio de Janeiro. The CVM was created by Law 6,385 in 1976 and its structure was recently modified by Law 10,303/01, Law 10,411 of 02/26/02, and Presidential Decree 3,995. Based on the reform implemented, the CVM is defined as an autonomous authority with a special regime that presents the following characteristics: (i) legal persona and own assets, with financial and budgetary autonomy; (ii) independent administrative authority, except for sanctioning procedures; (iii) political autonomy ensured by the stability of its leaders; and (iv) absence of hierarchical subordination, although it is attached to the Ministry of Finance. The CVM is empowered to regulate, supervise, and penalize all the actors in the Brazilian capital market. In this regard, its functions are related primarily to: (i) the registration of publicly-traded companies; (ii) the registration of public offers; (iii) the accreditation of independent auditors and mutual fund managers; (iv) the establishment of regulations referring to the creation, operation, and operational procedures of Brazil's stock exchanges; (v) securities intermediation and negotiation; (vi) suspension and/or cancellation of registrations, permits, or authorizations; (vii) suspension of the negotiation, issuing, and distribution of securities; (viii) suspension of exchange operations; and (ix) the investigation and punishment of any irregularity in the securities market.

### **B. Execution and administration**

- 5.2 Because of the World Bank's technical-assistance operation, a project management unit (PMU) has been set up within the CVM's Administrative-Financial Superintendency. The project team considers it essential that this same unit have responsibility for both operations for purposes of coordination, in view of their complementary status. With regard to the program, the PMU will be responsible for administrative coordination—including calls for bids and contracting, finances, and accounting—and for general control and implementation of the program. The PMU will share the technical management of the proposed activities with the requesting areas (superintendencies benefiting from the products to be developed<sup>9</sup>) and will provide initial approval for the results of the consulting work commissioned. The CVM's Administrative-Financial Superintendent will act as general coordinator of the program and will be assisted by the technical officer in charge of the program, who will be chosen from within the unit. With the World Bank's technical assistance project, the PMU has the administration services of the United Nations Development Programme (UNDP) at its disposal and will continue to have them

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<sup>9</sup> The CVM's superintendencies and units that will benefit from the program include the Superintendencies for Investor Protection and Guidance, International Relations, Information Technology, Business Registration, and Foreign Investors, as well as the Market Structure and Electronic Systems Offices.

during the program for purposes of consistency between the two operations and because of a shortage of resources. The PMU is comprised of a coordinator, three analysts, and one technical support staff, the costs of which will be covered exclusively from counterpart resources, including UNDP administration costs. The activities to be carried out by the PMU include: (i) supervision of fulfillment of program objectives and targets; (ii) review and presentation of the annual plan of program activities and the budget, including use of the local contribution; (iii) allocation of human and financial resources to ensure continuity in the execution of program activities; and (iv) approval of the hiring of technical staff and specialized consultants necessary to conduct the program.

- 5.3 The program execution period will be 36 months, with a disbursement period of 42 months. MIF funds will be disbursed by means of a revolving fund in an amount equivalent to 10% of the total MIF contribution, pursuant to the Bank's procedures.

**C. Accounting and financial audits**

- 5.4 *Accounting.* The executing agency will establish and be responsible for maintaining suitable accounting, financial, internal control, and filing systems that will make it possible to identify the sources and uses of program funds. The accounting system will be organized in such a way that it provides necessary documents, simplifies verification of transactions, and allows for the timely preparation of financial statements and reports. Program-related records will be filed so that: (i) amounts received from various sources can be identified; (ii) program expenditures are reported in accordance with a chart of accounts previously approved by the Bank, that differentiates between MIF contributions and funds from other sources; and (iii) details are included that are needed to identify goods acquired and services contracted as well as the use of such goods and services. The executing agency will also open separate and specific bank accounts for administration of the MIF contribution and for local counterpart funds. Lastly, the executing agency will process requests for disbursement and respective expense justifications, pursuant to the Bank's disbursement procedures.
- 5.5 *Financial audits.* The executing agency will submit audited financial statements to the Bank within 90 days of the end of each fiscal year (as at 31 December) during program execution. Similarly, 90 days after the final disbursement of the program, the executing agency will submit final audited financial statements to the Bank covering the Bank's contribution and the local counterpart funds. The financial statements are to be prepared by a firm of independent auditors acceptable to the Bank. The costs will be financed with funds from the MIF contribution, pursuant to Bank procedures.

**D. Degree of preparation**

- 5.6 The proposed design, budget, and activities have been prepared with involvement by program participants with the technical assistance from experts on some of the topics and from the Bank's team. The CVM had already created the PMU<sup>10</sup> and is moving forward on several of the preparatory activities.

**VI. MONITORING AND EVALUATION**

- 6.1 Annex I provides elements for the execution, monitoring, and evaluation of the program through a logical framework. The CVM will present progress reports on program execution every six months. The reports will describe status of program execution overall and, among other things, the quality and fulfillment of program objectives, the program's financial performance, and the status of procurement of goods and contracting of consultants. Each progress report will be delivered to the Bank's Country office for approval within 60 days of the end of the respective six-month period and a final report within 60 days of the last disbursement. The Country Office will use such reports to monitor the program and to prepare a completion report within three months of the last disbursement.
- 6.2 *Evaluation.* The program calls for two evaluations by independent consultants hired by the Bank with MIF resources. One will be conducted 18 months after the first disbursement or when 50% of the MIF's contribution has been disbursed, whichever comes first, and will consider at least the following: (i) the CVM's execution capacity; (ii) the startup of the services provided for under the program; (iii) the need for new services; (iv) the quality of the services offered through the training and technical assistance activities; (v) the degree of fulfillment and quality of services provided; and (vi) user satisfaction. The final evaluation will be conducted within three months of completion of program execution and prior to the final disbursement. It will consider: (i) the degree of fulfillment of the program's specific objectives; (ii) the quality of the services offered; (iii) the beneficiaries' satisfaction as measured through surveys; and (iv) program sustainability.

**VII. PROGRAM RATIONALE AND RISKS**

**A. Program rationale**

- 7.1 The program is justified on the basis of: (i) the importance of the role of capital markets in business financing (as an alternative to strictly bank financing) and the passing of risk processes; (ii) the processes initiated in the Brazilian markets from the public standpoint (through approval of the respective laws and adjustment to

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<sup>10</sup> See paragraph 5.2.

international standards); (iii) the initiatives undertaken from the private standpoint that show commitment to the modernization undertaken by the public sector; (iv) the importance of institutional investment; (v) the lack of development of retail investment; (vi) the importance of the latter to the deepening of markets; (vii) the role of transparency of information in such deepening processes; (viii) the importance of mechanisms of trust among actors in the intermediation process and quality of their performance; (ix) the central role of regulatory and supervisory agencies (properly issuing implementing regulations, ensuring compliance, and supervising the work of the markets, etc.); (x) the relevance of inter-market competitiveness processes; and (xi) the need to promote regional integration in the context of MERCOSUR and Chile.

- 7.2 From this standpoint, the ultimate beneficiary of the program is the Brazilian economy and the effective allocation of resources in the process of channeling savings towards investment. The immediate beneficiaries, therefore, are the participants on both sides of the equation, investors and businesses participating in the securities circuits as well as market actors and intermediaries. In addition, as explained in paragraph 2.9, the region's capital markets could indirectly benefit as a consequence of what could be called the groundswell of a program like this one.

## **B. Risks**

- 7.3 As a consequence of the situation described, the program risks are associated with its execution, given its strong complementarity. Indeed, the program is designed to complement the World Bank's technical assistance and achieve the overall strengthening of the CVM. From this perspective, one of the main risks of the program is that even though its specific objectives might be accomplished, if the objectives of the World Bank's project are not, then the goal of overall strengthening will not be reached. In order to achieve the complementarity and minimize the aforementioned risk, the selected design opted for an executing unit that was common to both projects. Moreover, specific contractual clauses are being included that seek to ensure the two projects' complementarity as well as their coordinated execution (see paragraphs 9.2 and 9.3).
- 7.4 It is worth adding that component 5 involves some associated risks from a dual perspective: on the one hand, the innovation that the initiative assumes in the region in the area of capital markets and, on the other, sustainability. The solution to both risks lies, to a large extent, in the hands of the CVM, which is responsible for promoting the forums to be created and for maintaining them initially with the necessary resources, should they prove viable.
- 7.5 From an official standpoint, it should be noted that the reforms introduced by Law 10,303, Presidential Decree 3,995, Temporary Measure 8, and Law 10,411 (which replaces the latter) followed a process that has resulted in a direct challenge of

unconstitutionality<sup>11</sup> by the Brazilian Bar Association [Ordem dos Advogados do Brasil] (OAB). A possible declaration of unconstitutionality would assume: (i) the loss of legal support for execution of certain components of the program;<sup>12</sup> and (ii) the acts executed on the basis of those legal instruments would probably be considered invalid.

### **C. Environmental and social considerations**

- 7.6 This operation was analyzed and approved by the Technical Review Group (TRG 04-02) of the Committee on Environment and Social Impact on 1 February 2002. Mention was made of the need to offer transparent information to investors on the environmental liabilities or environmental risks of the public enterprises (publicly-traded corporations) that could affect their investors' returns. It should be noted that the program's design includes a component exclusively aimed at providing access to information for investors to make sufficiently informed decisions. In this regard, the purpose of the program's third component (support for transparency) is to support the CVM in creating an electronic system for the registration of securities issues and in the digitization of the relevant part of its document files that will be accessible to the public (see paragraphs 3.9 to 3.11).

## **VIII. EXCEPTIONS TO BANK POLICY**

- 8.1 Program execution will require no exceptions to current Bank policies.

## **IX. SPECIAL CONTRACTUAL CONDITIONS**

- 9.1 The CVM will be required to present evidence to the Bank, as a condition precedent to the first disbursement of the MIF resources, that the PMU has the functional capacity and staff needed to execute the program.
- 9.2 At the beginning of each year, the CVM will provide evidence that it has taken the necessary measures to ensure that the activities to be financed by the World Bank's technical assistance project do not overlap with the program activities. To this end, budget items substantiating each program action for the following year, associated with the accounting and financial audits mentioned in paragraphs 5.4 and 5.5 will be provided.

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<sup>11</sup> The OAB asked that Provisional Measure 8 and Decree 3,995 be declared unconstitutional. In the case of the provisional measure, the rationale is that the Constitution prohibits the publication of provisional measures on matters contained in bills approved by Congress and pending presidential veto or approval. With regard to the decree, it is illegal under the Constitution for decrees to alter the content of a law.

<sup>12</sup> Primarily the following components could be affected: 4, 1.1(i), and, in part, 1.1(ii).

- 9.3 As a condition precedent to disbursement of the resources for actions to prepare consolidated regulations for the CVM's policy and legislation, called for under component 1, the CVM must present evidence that the process of updating the affected regulations—supported by the World Bank—has been completed.

**LOGICAL FRAMEWORK**  
**MODERNIZATION AND INSTITUTIONAL STRENGTHENING OF THE COMISSÃO DE VALORES MOBILIÁRIOS (CVM)**

NARRATIVE SUMMARY OF OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p><b>GOAL:</b></p> <p>Promote the deepening of Brazilian capital markets given their importance in the financing of companies, the reduction in the cost of capital, and the effective allocation of resources between savings and investment</p>	<ul style="list-style-type: none"> <li>• Increase in the depth, efficiency, transparency, and protection of investors in Brazilian capital markets</li> <li>• Increase in the quality of market oversight</li> </ul>	<p><b>Sector:</b></p> <ul style="list-style-type: none"> <li>• Changes in trading volumes in the secondary markets</li> <li>• Changes in the number of final investors in the stock market</li> <li>• Changes in the number of hits on the CVM's website</li> <li>• Changes in the number of inspections, files processed, and penalties imposed by the CVM.</li> </ul>	<ul style="list-style-type: none"> <li>• The government continues with the process of reforms regarding capital markets</li> <li>• Stable macroeconomic conditions</li> </ul>
<p><b>PURPOSE:</b></p> <p>Comprehensive strengthening and modernization of the CVM to complement the completed World Bank technical-assistance project</p>	<ul style="list-style-type: none"> <li>• The diagnostic studies have been performed, the strategies to be followed have been formulated, and the action plans have been developed</li> <li>• The regulatory measures have been approved</li> <li>• The technical procedures proposed for the professional quality certification program are under way and the professionals participating in the securities market are beginning to follow them</li> </ul>	<p><b>Project:</b></p> <ul style="list-style-type: none"> <li>• Final evaluation of the project</li> </ul>	<ul style="list-style-type: none"> <li>• The government continues to support the reforms initiated regarding the CVM's areas of authority and power.</li> </ul>
<p><b>COMPONENTS:</b></p> <p>1. Update of the regulatory framework designed and information gathered to make future integration processes possible</p>	<ul style="list-style-type: none"> <li>• Proposals made involving regulations for derivatives market and consolidated text of CVM regulations</li> <li>• Analysis of comparative legislation completed</li> </ul>	<ul style="list-style-type: none"> <li>• The CVM's semiannual reports, the two independent evaluations called for in the operation, and regular communications between the CVM and the Country Office</li> </ul>	<ul style="list-style-type: none"> <li>• The CVM is able to allocate human, technical, and financial resources to the project to ensure its performance</li> </ul>

NARRATIVE SUMMARY OF OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
2. Guidelines for a competitive stock market designed	<ul style="list-style-type: none"> <li>• Study involving <i>e-securities</i> and <i>e-commerce (internet)</i> conducted</li> <li>• Study on companies in the market conducted</li> <li>• Action plans designed, if necessary</li> </ul>	<ul style="list-style-type: none"> <li>• The CVM's semiannual reports, the two independent evaluations called for in the operation, and regular communications between the CVM and the Country Office</li> </ul>	<ul style="list-style-type: none"> <li>• The CVM is able to allocate human, technical, and financial resources to the project to ensure its performance</li> <li>• There is constant coordination among the various units of the CVM</li> </ul>
3. Modernization of the CVM's registration processes done	<ul style="list-style-type: none"> <li>• Process of modernization of the current stock issues registration system completed</li> <li>• Number of documents digitized in proportion to the amount of time that the project has been under way at the time of the midterm and final evaluations of the project</li> </ul>	<ul style="list-style-type: none"> <li>• The CVM's semiannual reports, the two independent evaluations called for in the operation, and regular communications between the CVM and the Country Office</li> </ul>	<ul style="list-style-type: none"> <li>• The CVM is able to allocate human, technical, and financial resources to the project to ensure its performance</li> </ul>
4. Derivatives market completely supervised by the CVM	<ul style="list-style-type: none"> <li>• Specific system for monitoring market movements implemented</li> <li>• Improvements in the handling of off-line data received from CETIP and BP&amp;F implemented</li> <li>• Electronic filing systems for data and documents created</li> </ul>	<ul style="list-style-type: none"> <li>• The CVM's semiannual reports, the two independent evaluations called for in the operation, and regular communications between the CVM and the Country Office</li> </ul>	<ul style="list-style-type: none"> <li>• The CVM is able to allocate human, technical, and financial resources to the project to ensure its performance</li> <li>• There is constant coordination among the various units of the CVM</li> <li>• CETIP and BM&amp;F data received "on line" and "off line"</li> </ul>
5. Program for professional quality certification in the stock market created and in operation	<ul style="list-style-type: none"> <li>• Technical formulation of the professional quality certification program in the capital markets done</li> <li>• Applicable collegiate bodies that the CVM deems necessary for the institutionalization of the Brazilian certification system created</li> <li>• Seminars for certification program dissemination conducted</li> <li>• Certification program approved by the various parties involved and Brazilian certification system created</li> </ul>	<ul style="list-style-type: none"> <li>• The CVM's semiannual reports, the two independent evaluations called for in the operation, and regular communications between the CVM and the Country Office</li> </ul>	<ul style="list-style-type: none"> <li>• The CVM is able to allocate human, technical, and financial resources to the project to ensure its performance</li> <li>• There is constant coordination among the various units of the CVM</li> <li>• The various sectors affected by the professional quality certification program are interested and participate</li> </ul>

NARRATIVE SUMMARY OF OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p><b>ACTIVITIES</b></p> <p><u>Component I</u></p> <p><i>Update of the regulatory framework designed and information gathered to make future integration processes possible.</i></p> <p>1.1 Hire consulting services to prepare respective regulations on the derivatives market</p> <p>1.2 Hire consulting services to prepare proposed consolidated regulations for the CVM's policies and legislation</p> <p>1.3 Hire consulting services to:</p> <ul style="list-style-type: none"> <li>- Compare securities market legislation in the various countries of MERCOSUR and Chile.</li> <li>- Prepare comparative and individual charts on capital market services in MERCOSUR and Chile.</li> </ul>	<p>1. The total value of the component is approximately US\$374,000</p> <p>1.1 Consulting services for an amount of approximately US\$110,000</p> <p>1.2 Consulting services for an amount of approximately US\$176,000</p> <p>1.3 Consulting services for an amount of approximately US\$88,000</p>	<p>1. Accounting records kept by the PMU in the CVM pursuant to the Bank's policies</p>	<p>1. The CVM has sufficient funds to provide its counterpart in the various components</p> <p>1. Consulting services contracted on time and to standard</p> <p>1.2 Proposed regulations financed by the World Bank's technical-assistance project are finalized for purposes of consolidation</p>
<p><u>Component II</u></p> <p><i>Guidelines for a competitive securities market designed</i></p> <p>2.1 Hire consulting services to:</p> <ul style="list-style-type: none"> <li>- Prepare a frame of reference for international best practices in markets.</li> <li>- Compare the frame of reference with the current situation in Brazil, Chile, Argentina, Paraguay and Uruguay.</li> <li>- Recommend specific actions to make the Brazilian market more competitive</li> </ul>	<p>2. The total value of the component is approximately US\$211,000</p> <p>2.1 Consulting services for an amount of approximately US\$211,000</p>	<p>2. Accounting records kept by the PMU in the CVM pursuant to the Bank's policies</p>	<p>2. The CVM has sufficient funds to provide its counterpart in the various components</p> <p>2. Consulting services contracted on time and to standard</p>

NARRATIVE SUMMARY OF OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p><u>Component III</u></p> <p><i>Modernization of the CVM's registration system done</i></p> <p>3.1 Contract consulting services to develop and install a mechanism for control and validation of data involving relevant facts on issuers</p> <p>3.2 Acquire the software and hardware needed to implement the aforementioned mechanism</p> <p>3.3 Train CVM staff in the use of the new system</p> <p>3.4 Contract consulting services to:</p> <ul style="list-style-type: none"> <li>- Select and prepare relevant documents for digitization</li> <li>- Scan and index selected documents</li> </ul>	<p>3. Total value of the component is approximately US\$1,209,000</p> <p>3.1 Consulting services for an amount of approximately US\$378,500</p> <p>3.2 Software and hardware for approximately US\$198,000</p> <p>3.3 Approximate cost of the activity is US\$19,000</p> <p>3.4 Consulting services for approximately US\$613,500</p>	<p>3. Accounting records kept by the PMU in the CVM pursuant to the Bank's policies</p>	<p>3. The CVM has sufficient funds to provide its counterpart in the various components</p> <p>3. Consulting services contracted on time and to standard</p>
<p><u>Component IV</u></p> <p><i>Derivatives market completely supervised by the CVM</i></p> <p>4.1 Contract consulting services to define the characteristics of the systems to be implemented</p> <p>4.2 Acquire software and hardware to implement the systems designed</p>	<p>4. The total value of the component is approximately US\$899,000</p> <p>4.1 Consulting services for an amount of approximately US\$700,000</p> <p>4.2 Software and hardware for approximately US\$199,000</p>	<p>4. Accounting records kept by the PMU in the CVM pursuant to the Bank's policies</p>	<p>4. The CVM has sufficient funds to provide its counterpart in the various components</p> <p>4. Consulting services contracted on time and to standard</p>

NARRATIVE SUMMARY OF OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p><u>Component V</u></p> <p><i>Program for training and professional quality certification in the securities market created and in operation</i></p> <p>5.1 Contract consulting services to:</p> <ul style="list-style-type: none"> <li>- Analyze the structure and evolution of securities market employment</li> <li>- Prepare job guidelines and define professional profiles</li> <li>- Design evaluation procedures</li> <li>- Prepare learning guidelines</li> </ul> <p>5.2 Create the national council for institutionalization of the Brazilian professional quality certification system</p>	<p>5. Total value of the component is approximately US\$ 798,000</p> <p>5.1 Consulting services for an amount of approximately US\$624,500</p> <p>5.2 Approximate cost of the activity is US\$173,500</p>	<p>5. Accounting records kept by the PMU in the CVM pursuant to the Bank's policies</p>	<p>5. The CVM has sufficient funds to provide its counterpart in the various components</p> <p>5. Consulting services contracted on time and to standard</p>